Docket Nos. 00-0620/00-0621
(Consolidated)
ICC Staff Exhibit 3.0

REBUTTAL TESTIMONY

OF

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ECONOMIC ANALYST

ILLINOIS COMMERCE COMMISSION

ENERGY DIVISION -- POLICY SECTION

NORTHERN ILLINOIS GAS COMPANY

d/b/a Nicor Gas Company

DOCKET NOS. 00-0620/00-0621

CUSTOMER SELECT PROGRAM

February 9, 2001

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ATTACHMENTS

I. Introduction

Q. Please state your name and business address.

A. Charles C. S. Iannello, 527 East Capitol Avenue, Springfield, IL 62701.

Q. Are you the same Charles C. S. Iannello that previously testified in this case?

A. Yes.

Q. What is the purpose of your Rebuttal Testimony?

A. I will respond to the Rebuttal Testimony of Nicor Witnesses Harms and Gilmore and the Direct Testimony of Governmental and Public Intervenor ("GCI") witnesses Alexander and Mierzwa.

Q. Are there any corrections that you would like to make to your Direct Testimony?

A. Yes, the statement on page 6, lines 138-139, of my Direct Testimony is incorrect and should be eliminated.

Q. Does this change have any effect on the recommendations that you have made throughout this proceeding?

A. No.

II. Rebuttal to Nicor Witness Harms

A. Group Additions Fee

Q. Please restate your proposal for recovering the costs associated with customer switching.

A. Nicor proposes to charge suppliers a $10.00 Group Additions charge each time they sign-up a new customer. I propose to eliminate the Group Additions charge and recover the costs of customer switching through the monthly Customer Account charge. The Customer Account charge is assessed to each supplier based on the number of customers served by the supplier. Given Nicor's estimate for the level of customer switching, my proposal would increase the monthly Customer Account charge by $.04 per customer.

Q. Please describe the advantage of your proposal for recovering customer switching costs and the effect it will have on suppliers and customers in the Customer Select Program.

A. Nicor's proposal, to charge suppliers $10.00 each time they sign up a new customer, has the potential to act as a barrier to switching by raising the cost of signing away customers from other suppliers. If this charge becomes too burdensome, suppliers may drop out of the program altogether and, in so doing, reduce the extent of competitive behavior by the remaining smaller group of competitors. All customers would be harmed if Nicor's proposed Group Additions Charge reduced the level of competition in the Customer Select program. Conversely, all Customers would benefit if my proposal, to recover the costs of switching through the Customer Account Charge, resulted in a more competitive market. I expect that Nicor's proposed $10.00 Group Additions charge would have the most detrimental effect on residential customers because of the narrow profit margin for serving residential customers.

Q. Mr. Harms refers to your claim that there are narrow profit margins for serving residential customers as an "unsubstantiated assumption". Do you have any information that supports your claim?

A. Yes, I have participated in both formal and informal discussions with representatives from natural gas marketing companies and local distribution companies that have unbundled residential natural gas service. The statement made in my direct testimony was based on these discussions and my knowledge of natural gas prices, costs associated with gas supply purchasing, and an average residential customer's annual consumption. Since preparing that Direct Testimony, I have also discovered a reference that quantified the margin for serving a residential customer as an average of $25.00 per year while the cost of pursuing and signing a residential customer was calculated to be $200. This information is included in my response to Nicor's data request CCSI 28, which is attached to my Rebuttal Testimony as ICC Exhibit 3.1.

I have found additional information since I responded to Nicor's data request. This information is included in a response by Nicor witness Harms to Citizens' Utility Board's ("CUB") data request CUB 2.9, which is attached to my Rebuttal Testimony as ICC Exhibit 3.2. In this data request response, Mr. Harms discusses the difficulties Nicor has had in attracting suppliers to the Customer Select program. He states that, "Additionally, Nicor Gas has been a low cost provider of gas and it may be difficult for some suppliers to earn, in their opinion, a satisfactory return on their investment." While not referring specifically to suppliers serving residential customers, Mr. Harms nevertheless concedes that margins for serving customers in the program in general may be what suppliers consider to be insufficient.

Finally, the number of suppliers actively marketing to residential customer in the Customer Select program may be evidence of the narrow margin for serving residential customers. There are currently 280,000 residential customers eligible for service under the Customer Select program, but there are only three suppliers actively marketing to these customers. Higher margins would attract more than three suppliers.

Q. Mr. Harms points out that the Peoples Gas Light and Coke Company's ("Peoples") Group Additions charge in its small volume transportation program is the same as that proposed by Nicor. Does Nicor's proposed Customer Select program differ from Peoples' small volume transportation program in any fundamental way?

A. Yes. Peoples' program is available to commercial customers for whom recovery of the additional fee is likely to be a smaller component of the total bill than for residential customers. Nicor's proposed Customer Select program would be available to approximately 1.9 million residential customers whereas Peoples' small volume transportation program is not available to any residential customers.

Q. Mr. Harms claims that you suggest that any fee charged by the Company could pose a "barrier to entry" and therefore be anti-competitive. How do you respond to Mr. Harms' claims?

A. While any fee charged to suppliers has the potential to be a barrier to entry, I certainly would not claim that all fees are "anti-competitive". Just like any other cost input, fees and charges assessed in the Customer Select program directly reduce a supplier's profit margin. Nicor is not assessed any of the Customer Select fees for providing sales service and, therefore, does not pass these costs on to customers through its PGA charge. Thus, a limit exists on the amount of charges and fees that suppliers can incur before they would lose the ability to compete with Nicor's PGA rate. Suppliers serving residential customers will suffer the greatest impact because, as I stated on page 15 of my Direct Testimony, the margin for serving residential customers is relatively minimal.

In addition, fees and charges may be anti-competitive by disadvantaging suppliers that compete with Nicor's affiliate Nicor Energy L.L.C.. If the revenues collected from the charges and fees assessed to suppliers exceed the incremental cost of offering the Customer Select program, non-affiliated suppliers would incur greater costs while the corporate entity Nicor would simply experience a transfer of revenues from one sister company to another. GCI witness Mierzwa raised this same point on page 13 of his Direct Testimony.

Q. On page 3, lines 8 -18, Mr. Harms claims that the tax savings, which Nicor can not avoid, are enough to offset Nicor's proposed charges for a supplier with 10,000 customers and a level of 5% customer additions. How do you respond to this characterization?

A. First, there is only one supplier participating in Customer Select with more than 10,000 residential customers. For suppliers serving a smaller number of customers, fixed per supplier charges will have a greater impact on these suppliers. Second, I do not expect taxing bodies to ignore the fact that their tax revenues are dwindling away if the number of customers taking service under Customer Select grows substantially. If local and state government realize a substantial reduction in tax revenues and begin to tax suppliers, suppliers will have to overcome additional cost burdens. Finally, Nicor may have significant economies of scale in supply purchasing and capacity management due to the approximately 1.7 million customers that it serves. These economies may reduce Nicor's supply costs and allow the Company to offer natural gas commodity at a relatively low price. Suppliers may also have to overcome these economies of scale.

Q. ~~That depends on the scope of the "competitive atmosphere", as Mr. Harms uses the term.~~ On page 5, line 22, of his rebuttal testimony, Mr. Harms states, "A healthy and vibrant competitive atmosphere already exists in the natural gas industry." Do you agree with this statement?

A. That depends on the specific segment of the natural gas industry to which Mr. Harms is referring. If Mr. Harms is referring to wholesale markets for natural gas or even retail markets for large volume customers in Nicor's service territory, I would tend to agree with his statement. However, I would strongly disagree if Mr. Harms is referring to the Customer Select Pilot Program. The level of competition in wholesale markets or even in retail markets for large volume customers is not indicative of the level of competition in Nicor's Customers Select Pilot Program.

B. Single Billing

Q. In his rebuttal testimony, Mr. Harms objects to your proposal for Nicor Gas to allow Customer Select suppliers to offer a single bill. Will you be responding to Mr. Harms?

A. Not at this time. Staff witness Schlaf will be adopting my testimony on the single billing issue and addressing Mr. Harm's objections to single billing for suppliers.

C. Customer Responsibility for Services Rendered to Supplier

Q. Mr. Harms continues to defend the Company's proposal to collect charges owed by defaulting suppliers from customers if the supplier fails to remit payment. Please restate your opinion of this proposal.

A. As I stated in my Direct Testimony, customers have no idea what types of charges that the Company assesses to suppliers. Suppliers are responsible for paying charges assessed by the Company under Rider 16, Supplier Aggregation Service. These charges include: Cash-Out Amounts, Gas Supply Charge, Firm Delivery Charge, Critical Day Non-Performance Charge excluding the $6.00 per therm charge, Operational Flow Order Non-Performance Charge, and the Required Daily Delivery Non-Performance Charge. Under the Company's proposal, customers would be asked to evaluate the risk of supplier default and the expected costs that they would incur if such an event took place. It is not appropriate or customers, particularly residential customers, to have to measure and bear such risks. This is an unfair practice that should not be allowed. Nicor is in a much better position to collect from defaulting suppliers, and I encourage them to do so.

D. Additional Recommendations by Nicor Witness Harms

Q. On page 1, lines 15 - 19, and page 2, lines 1-5, of his rebuttal testimony, Company witness Harms proposes to change the implementation date from March 1, 2001 to March 1, 2002. Do you have any concerns regarding Mr. Harms proposal?

A. Obviously, it is too late to implement the program by March 1, 2001. However, I believe that attempting to set an implementation date at this stage would be presumptuous given the range of recommendations from the various parties to this proceeding.

Q. In his Rebuttal Testimony, Mr. Harms proposes an additional Standard for the Standards of Conduct section of Rider 16, Supplier Aggregation Service. Is this a reasonable Standard to be included in the Company's tariff?

A. Mr. Harms proposes the following Standard:

> (l) in the event a supplier is found by the Illinois Commerce Commission or court of law to be in breach of a contract with a customer, the Commission may impose an appropriate reparation, to be administered by the Company

It is not appropriate for me to comment on the above-proposed language because it requires an interpretation of the law and Commission authority.

III. Rebuttal to Nicor Witness Gilmore

A. Operational Flow Orders

Q. On page 4, lines 9 through 14, of his Rebuttal Testimony, Mr. Gilmore claims that you have focused on one particular type of Opeerational Flow Order ("OFO"). Have you focused on a particular type of OFO?

A. Yes, I have focused on the type of OFO that would enable Nicor to limit the quantity of gas delivered to a potentially constrained city-gate station by Customer Select suppliers and require Customer Select suppliers to deliver gas to an unconstrained city-gate station. If suppliers are unable to arrange for delivery to an unconstrained city-gate station when such an OFO is called, the Company will assess an Operational Flow Order Non-performance Charge for each therm of under-delivery below the Required Daily Delivery Range. The non-cost based Operational Flow

Order Non-Performance Charge has been arbitrarily set at 200% of the high price of gas reported for Chicago citygate for under-deliveries and 50% of the low price for over-deliveries.

If suppliers' actions were insufficient to remedy the operational problem, Nicor would remedy the operational problem and pass the costs on to Customer Select suppliers only. I have focused on this type of OFO because I believe it is the most burdensome requirement that Nicor would be able to impose on Customer Select suppliers. Furthermore, this type of OFO best illustrates the inherent inequity of Nicor's proposal.

Q. Why is Nicor's proposed System Operational Controls section inequitable?

A. Nicor's proposed System Operational Controls section is inequitable because it would enable Nicor to impose requirements on Customers Select suppliers in order to resolve operational problems that were created by the actions all shippers including Nicor and non-Customer Select transportation customers. Thus, imposing OFOs on Customer Select suppliers would shift the costs of alleviating operational problems from all shippers onto Customer Select suppliers only.

Q. Please explain how OFOs would shift the cost of alleviating operational problems from all shippers to Customer Select suppliers.

A. OFOs would apply only to Customer Select suppliers because Nicor proposes to include the System Operational Controls section in Rider 16, Supplier Aggregation Service, which applies only to Customer Select suppliers. If multiple shippers were delivering gas to a specific city-gate station and Nicor determined that an operational problem could arise, Nicor would have the ability to issue an OFO limiting the deliveries of Customer Select suppliers only. Although all shippers may have had primary rights to deliver gas to that city-gate station, Nicor's OFO would have singled out Customer Select suppliers as the cause of the operational problem.

Q. How can Nicor determine which suppliers are responsible for creating operational problems at a specific city-gate station if all suppliers have the same delivery rights to that city-gate station?

A. It is normally impossible to pinpoint responsibility for operational problems because suppliers are not required to deliver gas to Nicor's system based on the location of the load they serve. That is, Nicor does not require suppliers to deliver gas to specific city-gate stations on Nicor's system under normal operating conditions. Any determination of responsibility for operational problems, other than a pro-rata application to all shippers, would be purely arbitrary and potentially discriminatory if left in the hands of Nicor. If all shippers have the same delivery rights to a specific city-gate station and Nicor determines that an operational problem may arise unless deliveries to that city-gate station are limited, OFOs should place limitations on deliveries from **all** shippers, not just Customer Select suppliers.

Q. Did Mr. Gilmore explain why OFOs of the type that limit deliveries to a specific city-gate station should apply to Customer Select suppliers only?

A. No. Instead, Mr. Gilmore stated that, "While not termed an "OFO", Nicor Gas has the authority to limit the volume of gas supply that it will confirm at pipeline interconnects when a system imbalance threatens system integrity." (Gilmore Rebuttal Testimony, p. 7) This authority is derived from the following language in the "Limitations on the Rendering of Gas Service" section of the Terms and Conditions in Nicor's tariff:

> The Company also reserves the right to limit, on any day, the volumes of Customer-owned gas delivered into the Company's system when, in the Company's sole judgement, the total gas supply to be delivered into the Company's system may cause an adverse effect on system operations.

The above language differs significantly from Nicor's proposed OFO language in several aspects. Most importantly, the above tariff provisions apply to all shippers delivering gas into Nicor's system rather than a specific class of shippers, such as Customer Select suppliers. Furthermore, the above language does not require shippers to arrange for deliveries to alternate city-gate stations nor does it make any mention of city-gate stations whatsoever. Despite these differences, Mr. Gilmore likens the above tariff provisions to the type of OFO that would limit deliveries at specific city-gate stations. Although I tend to disagree with Mr. Gilmore for the reasons listed above, I question why the OFO provision is necessary if the Company already has the ability to impose such restrictions on all shippers as Mr. Gilmore claims. If Mr. Gilmore's claim is true, then Nicor's proposed OFOs, which limit deliveries to specific city-gate stations, are merely redundant, but I do not believe this to be the case.

Q. Mr. Gilmore claims that non-Customer Select suppliers should not be subject to OFOs of the type that would increase or decrease the Required Daily Delivery because they are "responsible for the daily balancing of usage, storage and gas deliveries under the provisions of their tariff or are required to pay for full backup gas service as would a sales service customer." How do you respond to this claim?

A. Mr. Gilmore seems to suggest that transportation customers with full back-up service should be exempt from OFOs because they pay for the same balancing services as sales service customers. If this is correct, then Customer Select customers should also be exempt from the type of OFOs described above because Nicor recovers the same balancing costs from both Customer Select suppliers and sales service customers. The base rates charged to Customer Select customers and sales service customers are identical. Base rates include the cost of on-system storage facilities that are used by the Company for balancing both sales and Customer Select customers. Sales service customers are also assessed a Non-Commodity Gas Cost charge ("NCGC") that recovers the cost of balancing on interstate pipelines. Customer Select suppliers are assessed an Aggregator

Balancing Service Charge ("ABSC") that recovers the cost of balancing on interstate pipelines. Nicor's tariff refers to the ABSC as the "...usage level based counterpart to the NCGC." (Rider 6 - Gas Supply Cost). Mr. Gilmore's claim that non-customer select suppliers should be exempt from certain types of OFOs because they pay for additional balancing services should be rejected.

Q. On page 4, lines 15 through 20, of his Rebuttal Testimony, Mr. Gilmore asserts that you have ignored the possibility that Nicor Gas "...could have a legitimate concern related to the expansion of unbundling to all remaining sales customers." How do you respond to this assertion?

A. Actually, I find it quite plausible that Nicor Gas is concerned about the effects of expanding transportation service to all customers. Indeed, I recommend going beyond Nicor's proposal to include additional provisions in its tariff that allow it to impose certain restrictions on Customer Select suppliers. If Nicor is concerned about expanding transportation, I recommend that Nicor file a petition seeking *authority to impose the same or similar conditions on all suppliers rather than* Customer Select suppliers only. The cost of maintaining system reliability should not be born by a single class of Customer Select customers. To avoid undue discrimination, the cost of maintaining reliability should be born by all customers.

Q. Please discuss Mr. Gilmore's responses to your other concerns with the Company's proposed System Operational Control system and the manner in which OFOs would be implemented.

A. I discussed several concerns with OFOs in my Direct Testimony that were in addition my concern over the discriminatory nature of OFOs that I addressed above. These concerns are secondary to my concern over the discriminatory nature of Nicor's proposal and involve details about OFOs that would be more appropriately address in a separate proceeding. In my view, it is appropriate to consider OFOs in the broader context of all customers rather than piecemeal consideration of OFOs for Customer Select suppliers only. If Nicor were to file a comprehensive proposal, I believe that my concerns regarding varying costs among suppliers, information deficiencies, and incentive problems would need to be addressed in greater detail.

Q. On pages 14 and 15 of his rebuttal testimony, Mr. Gilmore proposes modifications to the program that he believes would be necessary if the Commission rejects Nicor's proposed System Operational Controls section in Rider 16, Supplier Aggregation Service. How do you respond to Mr. Gilmore's assertion that additional measures would be necessary if Nicor's proposal to implement OFOs through the Customer Select program is rejected by the Commission?

A. On page 15, lines 14-15, Mr. Gilmore characterizes these alternatives as inferior to Nicor's primary proposal. I agree with Mr. Gilmore. Not only are these proposals inferior, but both proposals exhibit the same shortfall as Nicor's primary proposal because they only apply to Customer Select customers and are, therefore, discriminatory in nature.

IV. Rebuttal to GCI Witness Alexander

A. Customer Education

Q. Ms. Alexander makes several recommendations concerning the level of education customers must receive in order to make rational decisions when choosing a natural gas supplier. Do you believe additional consumer education would benefit customers that are eligible to participate in the Customer Select program?

A. Yes. The Company's educational materials have been made available to Commission Staff since the inception of the Customer Select Pilot Program. I have reviewed these materials periodically, as they were made available to Staff. I have also reviewed these materials for the purpose of testifying in the instant proceeding.

I believe that the Company's effort to spread the message of the availability of Customer Select has been more than adequate. However, as Ms. Alexander noted in her Direct Testimony, Nicor did not teach customers how to shop for natural gas. The Company did take steps in that direction by providing customers with a list of questions to ask suppliers regarding pricing options, contract terms and length, billing options, points of contact and cancellation fees. The Company did not provide education that would assist customers in understanding the various pricing options offered by suppliers, the utility's PGA rate, and the volatility of natural gas prices.

While my opinion differs from Ms. Alexander's on some of the measures that the Commission must take to ensure that customers are able to make rational decisions when choosing a natural gas provider, I believe customers would benefit from additional education if it were properly designed. I recommend that a workshop process be initiated after the Commission's Order in the instant proceeding is issued. This workshop would focus on providing customers with additional tools to evaluate the differences between suppliers' offers and the utility's PGA rate and gain a better understanding of the natural gas industry. All parties would be welcome to participate in this workshop. This is not to suggest that the Commission initiate a customer education campaign from within the agency as Ms. Alexander recommends. I am unaware of any funding that is earmarked for such an endeavor. Rather, the workshop would allow interested parties to provide Nicor with guidance on how customer education should be designed for the Customer Select program. Based on the cooperation that Nicor has exhibited with Staff in developing the Customer Select Pilot Program, I would expect Nicor to be very receptive to input from outside parties.

Q. On page 17, lines 3-7, of her Direct Testimony, Ms. Alexander proposes that Nicor Gas "...develop a local consumer education plan that reflects the input and participation by local community-based organizations. This local education effort should target consumer information to hard to reach customers." What is your opinion of Ms. Alexander's proposal?

A. I do not object to this proposal. Consumer education may be more effective if it comes from varying sources such as local community-based organizations. Because consumers may tend to have an increased level of trust in these organizations, they may be more effective at educating customers on how to shop for natural gas. I have several concerns about Ms. Alexander's proposal that I would like see addressed before I can fully endorse such a plan. I would like to have a stronger understanding of how Ms. Alexander's proposal would be implemented. I would also like to know the success rate and popularity of such programs in other states. These are details that were omitted from Ms. Alexander's testimony, but could be explored further in a customer education workshop. I do believe that these efforts would ultimately have to be coordinated by Nicor but could be guided by the recommendations of workshop participants.

B. Uniform Price Disclosure

Q. In the above response, you stated that your opinion differs from Ms. Alexander's on some of the necessary measures that the Commission must take to ensure that customers are able to make rational decisions when choosing a natural gas provider. How does your opinion differ from Ms. Alexander's?

A. I am skeptical of uniform price disclosure as described by Ms. Alexander in her Direct Testimony. Uniform price disclosure can be problematic due to the fundamental difference between fixed prices and variable prices (such as the indexed rates charged by suppliers or the utility's PGA charge). The future value of variable prices could only be estimated due to the volatile nature of market indices and the utility's PGA charge. Fixed prices, on the other hand, would be known with certainty and would not require estimation. If historical prices were used to estimate variable rates, uniform disclosure of fixed and variable prices would actually be a comparison of expected future prices to historical prices respectively - two sets of prices that bear no necessary relationship to one another.

Natural gas prices have been among the most volatile prices of any publicly traded commodity. Natural gas prices are affected by innumerable factors including, but not limited to, weather, production levels, storage levels, oil prices, and electricity production. There is no reason to believe that this year's prices provide and accurate estimate of next year's prices. In short, historical prices are not good proxies for future prices.

Uniform price disclosure that relies on historical prices has the potential to mislead customers. For example, if gas prices were decreasing prior to the period when a consumer is shopping for natural gas and were expected to continue to decrease during future periods, fixed rates would appear to be a better deal than an estimation of variable rates based on historical information. Comparing these "uniformly" disclosed prices would lead the customer to enter into a fixed price contract prior to a period when prices were actually expected to decrease.

Finally, I should point out that the Commission has the legislative authority to require similar price disclosures for retail electric suppliers in Section 16-117(h) of the Illinois Public Utilities Act but has not exercised this authority to date. Perhaps consideration of uniform price disclosure requirements for natural gas suppliers in the Customer Select program should be contingent upon Commission action in the Illinois retail electricity market.

Q. Do you oppose disclosure of prices in a Terms of Service Disclosure?

A. No. I merely oppose forcing suppliers to characterize the price they offered based on historical data, performance against the utility's PGA charge, or any other characterization that could potentially mislead customers about the prices that they should expect to pay for natural gas under a particular offer.

C. Bill Format and Pricing and Usage Information

Q. Ms. Alexander raises several concerns about the information included on Nicor's bills and the format of the Nicor bill. Do you share these same concerns?

A. Ms. Alexander recommends that each Nicor bill contain historical usage and pricing information similar to that discussed above. I believe that this information would be useful to customers and should be included on the bill. However, I recommend that the inclusion of usage and pricing history on the bill complement, rather than replace, Nicor's system of providing usage and pricing information both annually and at the customers' request through the mail. If the Commission approves some form of single billing for suppliers, customers will no longer receive the Nicor bill containing the usage and pricing information and therefore would need to rely on an alternate source.

Ms. Alexander also identifies a problem with the supplier portion of Nicor's bill that is attached to her Direct Testimony as GCI Exhibit 1.2. She points out a discrepancy in the charges included in the supplier portion of the bill. Like Ms. Alexander, I do not know if the utility or the supplier assessed the charges in question. If the utility assessed the charges, they should not be included in the supplier's portion of the bill. The supplier's portion of the bill should be clearly subdivided and contain only charges assessed by the supplier.

Q. You mentioned usage and pricing information that Nicor provides to eligible customers on an annual basis and at the Customer's request. Do you have any recommendations about the format of this information?

A. Yes, I have reviewed the historical pricing and usage data that Nicor has provided to its customers, and I have the following recommendations. I propose that two additional columns be included to show total monthly natural gas supply cost and total monthly distribution charges. The difference between the regulated distribution charges and the natural gas supply cost should also be explained, and customers should be informed that they would pay the same distribution charges regardless of whether they stay on sales service or choose an alternative supplier. I also recommend that Nicor's historical PGA charges and distribution rates be made available on Nicor's web site. The pricing information on the web site and the pricing and usage information in the mailings should be updated on a monthly basis.

Nicor has indicated that customers can obtain a free copy of the usage and pricing information by calling a toll free number. This is a valuable service for customers who are trying to decide what their best supply option and should remain available to all customers for the life of the Customer Select program

D. Certification of Suppliers

Q. On page 35 and 36 of her Direct Testimony, Ms. Alexander urges the Commission to "...seek authority to license and directly enforce consumer protection programs and policies on natural gas suppliers for any large-scale choice program." Do you agree with this recommendation?

A. No, I view open access programs such as Customer Select as experiments in competition and not in alternative regulation. The Commission's primary role should remain the regulation of local monopoly utility companies, whether those utilities are providing bundled services or unbundled transportation services. Once consumers find their way to a competitive market for such things as natural gas commodity, the

Commission's expertise is not required or desirable, from my perspective. Having said all of that, I would certainly agree that the experiments (which seem to have proven extremely effective for large volume customers) may turn out to be less than fully successful for small volume customers, such as those targeted by "Customer Select." If that is the case, then the Commission should to revisit the consumer protection issues raised by Ms. Alexander. Depending on the degree and nature of such hypothetical failures, the Commission might reasonably conclude that the experiment should be terminated and small consumers returned to bundled rates for the foreseeable future. Certainly, we are not at that stage, now. In any event, I think the least attractive alternative is a mixed system of partial regulation and partial deregulation of marketers.

E. Problems with Competitive Suppliers

Ms. Alexander noted on page 34 lines 1-14, suppliers have "defaulted on their obligations to customers and failed to return prepayments or deposits owed to customers." I fully expect that similar incidents may take place in Illinois as the market weeds out suppliers because they operated inefficiently and could not compete with more efficient suppliers. These incidents have occurred in states that have either passed specific legislation requiring unbundling or required unbundling through Commission Order. Some of these states have the same consumer protections and supplier certification requirements that Ms. Alexander is recommending. If this program is approved as proposed or with the recommendations of **any** witness to this proceeding, the Commission should be prepared for incidents such as those referenced by Ms. Alexander and others that have already occurred in Nicor's pilot program.

I do not believe that it would be appropriate for the Commission to take on the responsibility of determining whether contracts between suppliers and customers were violated. I believe that customers should rely on the same protections that they have when they purchase any unregulated product. Direct Commission oversight of natural gas suppliers is not necessary to approve the Customer Select program with Staff's proposed modifications, nor is it desirable in my opinion.

That being said, the question of whether the Commission has the authority to pass rules allowing it to regulate gas suppliers is a legal question that would not be appropriate for me to answer. If the Commission does not have this authority, then such authority could only be attained through legislation. In any event, if the Commission decides to seek such authority, it is an issue that will have to be addressed outside of the instant proceeding.

Q. Ms. Alexander describes two concerns regarding the actions of Customer Select suppliers that have been the source of consumer complaints and confusion. Please discuss these concerns.

A. Overall, complaints about the program have been few. However, two significant concerns have been raised about supplier tactics. One concern involves Nicor

Energy L.L.C. and the other concern involves Santanna Energy Services ("Santanna").

Nicor Energy L.L.C's "Automatic Lock" option has been rightfully criticized as a confusing offer. Some customers apparently believed that they were receiving a fixed price for gas when, in fact, the conditions necessary for the "Automatic Lock" price to become effective were not satisfied. Customers that chose the "Automatic Lock" option are now purchasing gas at a market-based rate the monthly Chicago Area index plus 3.5¢.

A customer's greatest safeguard against unclear and ambiguous offers is the optional nature of service under the Customer Select program. An offer that is not clearly understood should not be accepted. While it is unfortunate that some customers may have been mislead by the "Automatic Lock" option, Nicor Energy L.L.C.'s variable rate charges should be relatively close to Nicor Gas Company's PGA charges[1]. To the extent that customers chose Nicor Energy L.L.C. over other supplier's offering what, in hindsight, was a relatively low fixed price, customers may have been somewhat disadvantaged by their choice of supplier. However, the market will discipline Nicor Energy L.L.C. because customers that are unhappy with Nicor Energy L.L.C.'s services may choose a different supplier next year.

[1] One should expect Nicor Gas Company's rates to closely follow the monthly Chicago Market Area index that Nicor Energy L.L.C. uses to determine its monthly charge. That is, the PGA is generally reflective of the variable prices that Nicor Gas Company pays to deliver gas into the Chicago area market.

The issue concerning Santanna is more troubling since Santanna is alleged to have violated contractual provisions. Santanna declared "*force majeure*" and shifted customers from a fixed rate to a floating rate. Customers may have legal recourse if Santanna violated its contracts. Like the Nicor Energy L.L.C. case, customers are not likely to incur charges on Santanna's variable rate that are significantly higher than Nicor's PGA rates. To the extent that customers chose Santanna over other suppliers offering a similar or higher but guaranteed price, those customers were disadvantaged by their choices. In any event, if it is determined that Santanna has violated contractual obligations, that history will likely tarnish Santanna's reputation in the long run.

Ms. Alexander refers to the Santanna incident as support for Commission regulation of suppliers. However, there would be no immediately obvious remedy for Santanna incidents, if the Commission had jurisdiction over suppliers. Gas prices have increased substantially since Santanna contracted with its customers. Gas prices rose from $2.90 per Mcf in March to almost $4.20 per Mcf in June when Santanna declared force majeure (and have subsequently increased to more than $10.00 per Mcf). If Santanna would have gone bankrupt absent the force majeure action, the Commission could have done little to help the customers anyway. GCI Exhibit 1.3, which includes two articles on a supplier bankruptcy in Western New

York, seems to confirm that customers are not likely to reimbursed when suppliers declare bankruptcy.

Q. On page 38 of her Direct Testimony, Ms. Alexander describes a generic complaint handling process that Nicor should follow when handling complaints about supplier conduct or the supplier portion of the bill. Do you believe that Nicor should have such procedures?

A. Yes. I believe that such procedures would aid in future evaluations of the program.

Q. On pages 39 -43 of her Direct Testimony, Ms. Alexander discusses a need for an affiliate code of conduct to prevent cross-subsidies and other affiliate abuses that allow affiliates to gain an unfair advantage in the competitive market. Do you recognize a need for standards that regulate interaction between gas utilities and their affiliates?

A. Yes. I believe that the evidence presented in the instant proceeding and elsewhere demonstrates a strong need for rules governing affiliate transactions between all gas utilities and their affiliates. Docket No. 00-0586 is an affiliate transaction rulemaking proceeding currently before the Commission. In addition, Nicor has filed a new operating agreement in Docket No. 00-0537. It is my opinion that Docket Nos. 00-0586 and 00-0537, rather this instant proceeding, are the appropriate areas to address the potential for cross-subsidization and other actions by utilities that allow affiliates to gain advantages in competitive markets that may reduce the efficiency of the marketplace.

Q. On page 46, lines 12 - 15, of her Direct Testimony, Ms. Alexander recommends that the Commission prohibit the use of the name and logo by an affiliate of Nicor Gas. If the use of similar name and logo is not prohibited, Ms. Alexander recommends that the Commission require affiliates who use similar name and logo "…to make specific disclosures and refrain from advertising designed to confuse the public." What is your position on the use of similar name and logo by affiliates of the incumbent utility?

A. I am aware of the confusion that Nicor Energy L.L.C's use of a similar name and logo may have created and the advantages that the use of this name and logo may have provided Nicor Energy L.L.C in the Customer Select program.

With respect to electric utilities and their affiliates, the Commission has already addressed the issue of prohibiting affiliates from using a similar name and logo in 83 Illinois Administrative Code Part 450 - Non-discrimination in Affiliate Transactions for Electric Utilities. Specifically, Section 450.25 states the following:

> Section 450.25 - Marketing and Advertising
>
> a) An electric utility shall neither jointly advertise nor jointly market its services or products with those of an affiliated interest in competition with ARES.

> b) Nothing in subsection (a) shall be construed as prohibiting an affiliated interest in competition with ARES from using the corporate name or logo of an electric utility or electric utility holding company.

A similar provision exists in Part 550.30 of the draft gas affiliate rule.

With respect to Ms. Alexander's disclosure recommendation, I am unaware of any Commission precedents. The Pennsylvania Public Utility Commission's disclosure provision listed on page 45 of Ms. Alexander's Direct Testimony seems like a reasonable requirement that could be added into the Standard of Conduct section of Rider 16, Supplier Aggregation Service.

V. Rebuttal to GCI witness Mierzwa

Q. On pages 13 and 14 of his Direct Testimony, Mr. Mierzwa discusses cost reductions that Nicor may experience as a result of offering the Customer Select program. Mr. Mierzwa identifies the potential cost reductions as "...lower cash working capital for gas in storage inventory, and lower cash working capital requirements for purchased gas costs and administrative and general costs associated with the acquisition and delivery of gas supplies." ?

A. I have reviewed Mr. Mierzwa's testimony on the potential cost savings, and I agree that areas of potential cost savings may exist that could offset some or all of the costs associated with offering the Customer Select program. I would like to see further analysis of such cost savings before I offer a recommendation on this issue.

Q. Does this conclude your testimony?

A. Yes.

CCSI 28:

At line 365, what is the margin for a Supplier serving residential customers?

Response:

The following language is found on lines 355 through lines 358 of Mr. Iannello's direct testimony:

> The **margin** for a supplier serving residential customers is minimal. The Group Additions Charge reduces the profitability of serving customers under the Customer Select Program, and may discourage suppliers from actively competing for small volume customers. (emphasis added)

In this section of his testimony, Mr. Iannello is referring to a supplier's profit margin per residential customer. It is Mr. Iannello's understanding that the profit margin for serving an average residential customer is relatively low compared to the profit margin for serving a *large volume commercial or industrial customer. This seems logical because of the* difference in consumption between residential customers and larger volume commercial or industrial customers. That is, if suppliers earn profits by selling gas, then suppliers earn greater profits from customers that consume greater amounts of gas.

Mr. Iannello's position is further supported by the National Regulatory Research Institute's Bulletin 99-05 "Household Participation in Gas Customer Choice Programs: Some Facts, Explanations, and Lessons Learned", in which it is stated, "A recent industry survey calculated that the cost of pursuing and signing one residential gas customer by a marketer is around $200, while the margin for that customer would average only $25 per year." (Costello, p.16)

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CUB 2.9 Q. Please discuss the factors that the Company believes have contributed to any difficulties encountered in attracting suppliers and customers to its program.

A. The Company believes that the limited number of eligible customers in the pilot program may contribute to some Suppliers not participating at this time. Additionally, Nicor Gas has been a low cost provider of gas and it may be difficult for some Suppliers to earn, in their opinion, a satisfactory return on their investment.

The Company believes that the pilot program has been very successful in attracting customers and anticipates that expanding the program throughout its service territory will encourage additional Suppliers and customers to participate.

Company Witness: Albert E. Harms